



CITY OF LODI

COUNCIL COMMUNICATION

AGENDA TITLE: Tax-exempt Financing For Termination Payment of Power Supply Contract with Washington Water Power Company.

MEETING DATE: November 20, 1996

SUBMITTED BY: Electric Utility Director

RECOMMENDED ACTION: That the City Council adopt the attached resolution authorizing tax-exempt financing of the payment to Washington Water Power Company for termination of the Northern California Power Agency (NCPA) - Washington Water Power Company (WWP) power supply contract.

BACKGROUND: Due to changes in the electric power marketplace, the NCPA - WWP contract became uneconomical and was cancelled. The City will realize an estimated net present value savings of \$300,000 to \$800,000 depending on the market value of capacity and transmission. The released share of the City's California-Oregon Transmission Project (COTP) previously dedicated to WWP power deliveries will now be used for the Seattle City Light power exchange contract and other Northwest power transactions.

There is an opportunity to save an estimated additional \$47,200 to \$70,800 by financing the WWP termination charge rather than paying from cash reserves. This savings results from the difference between taxable interest rates for cash reserves and the tax-exempt borrowing rate over the next four and one-half years.

All above savings will offset bulk purchased power expenses.

FUNDING: Not applicable

A handwritten signature in black ink, appearing to read "Alan N. Vallow".

Alan N. Vallow
Electric Utility Director

Prepared by Jack Stone, Director, Business Planning & Marketing

ANV/JLS/pn

Attachment

cc: City Attorney

APPROVED

A handwritten signature in black ink, appearing to read "H. Dixon Flynn".
H. Dixon Flynn
CITY MANAGER

Executive Summary

NCPA has executed an agreement to terminate the power supply contract with Washington Water Power Company (WWP). Termination of the power supply contract requires an upfront termination payment to WWP. The termination payment can either be funded with the proceeds from tax-exempt bonds issued by NCPA or from operating reserves of each of the participating members.

Issuing tax-exempt bonds to fund the termination payment allows the participating members to keep their operating reserves intact which they can invest at taxable rates that are significantly higher than the tax-exempt borrowing rate.

The savings or positive arbitrage that accrues to the participating members by issuing tax-exempt bonds and leaving their operating reserves invested in taxable investments ranges from \$400,000 to \$600,000 on a present value basis (see revised savings analysis developed by NCPA staff).

In order for tax-exempt bonds to be issued, the governing boards of the participating members must approve agreements modeled after existing NCPA agreements to unconditionally pay debt service.

Due to the short duration of this proposed transaction (approximately 4.5 years) any delays beyond a December 1, 1996 closing will reduce savings by approximately \$25,000 per month. Time, is therefore, of the essence. Attached are some key questions which the participants may pose relative to the proposed tax-exempt financing alternative.

BPA/WWP Contract Termination

Choices:

- A. Pay \$17,151,288 to WWP.
- B. Keep the \$17,151,288 invested and float a \$19,505,000 bond issue. Pay debt service G.O.R. as it comes due, but keep the remaining balance invested. Assuming earnings on the G.O.R. continue at approximately current rates, participants will obtain all-in net p.v. savings of approximately \$400,000 to \$600,000

		Share of Termination Chrg.	Available G.O.R. Balance 8/31/1996**	Bond Issuance Alternative Share of Savings	
				Min.	Max.
Alameda	11.000%	\$1,886,641	\$11,309,557	\$44,000	\$66,000
Halsburg	1.800%	308,723	1,563,772	7,200	10,800
Lodi	11.800%	2,023,852	15,775,097	47,200	70,800
Lompoc	2.600%	445,933	2,614,624	10,400	15,600
Palo Alto	11.600%	1,989,550	5,392,280	46,400	69,600
Roseville	22.200%	3,807,587	3,036,448	88,800	133,200
Turlock	36.000%	6,174,463	2,396,447 (c)	144,000	216,000
Ukiah	3.000%	514,539	1,300,343	12,000	18,000
	100.000%	\$17,151,288	\$43,388,566	\$400,000	\$600,000

** Does not include FY 1994-95 Settlement expected to be approx. \$6 million plus.

- (A) G O R. investments current avrg. interest rate 6.307% or bond equivalent yield of 5.827%
- (B) If financed, Agency participants would obtain a cash savings out of the deal of between \$400,000 and \$600,000 depending on how the bond escrow is invested.
- (C) It appears, all members except for Turlock appear to have sufficient G.O.R. funds available to fund direct payments if desired.

NCPA Staff Report to Member Agencies

Questions and Answers

1) Why issue bonds to fund the termination payment when cash reserves are available to make the termination payment?

Cash reserves can be invested at taxable rates significantly higher than the tax-exempt borrowing rate generating positive arbitrage (risk free income) or cost savings for each agency participating in the bond issue. Issuing bonds allows cash reserves to be saved for other purposes such as costs that cannot be paid for with tax-exempt bond proceeds. Maintaining healthy levels of cash reserves during this period of transition in the power industry is viewed favorably by the rating agencies.

2) What are the responsibilities of each of the participating members in implementing the bond issue?

Each governing board will have to approve a new or amended agreement drafted by bond counsel unconditionally obligating them to pay their share of debt service on the bond issue with the same rate covenant that already exists in other third phase agreements. The general counsel for each district will have to provide an opinion similar to the ones provided for other NCPA bond issues. Finally each member will have to provide continuing disclosure on their operations as they already have to do for other bond issues.

3) Will the additional debt increase our fixed power costs?

No, actually the tax-exempt bond issuance should decrease your annual fixed cost because the earnings on your invested cash reserves (not otherwise used to make the termination payment) will be greater than the interest cost on the bond issue.

4) Are the estimated savings from the tax-exempt bond issuance net of all costs?

Yes. The estimated savings takes into account all costs attendant to the issuance of bonds including legal, financial advisory, underwriting, printing, insurance, initial trustee fees, and credit ratings.

5) How will additional debt be viewed from an accounting perspective?

The balance sheet will show additional short term debt (under 1 year) and long term debt (over 1 year) balanced by an equal amount of invested cash reserves that would otherwise have been used to terminate the contract. The income statement will show earnings on the cash reserves greater than the interest expense on the debt issued.

6) How can you insure that the cash taxable investments will generate more income than the tax-exempt interest expense (positive arbitrage)?

By investing the cash reserves in taxable securities with an average life equal to or greater than the tax-exempt bonds.

7) How can the debt be eliminated before its final maturity?

The debt can be legally defeased at any time by setting up an escrow of US. Treasuries or State and Local Government Securities (SLGS) pledged to pay the debt service on the bonds. The yield on the escrow can not be above the bond or arbitrage yield there by precluding any future positive arbitrage on the cash reserves invested in the escrow. The bonds can also be purchased in the open market, which could be less costly than legally defeasing the bonds.

RESOLUTION NO. 96-172

A RESOLUTION OF THE LODI CITY COUNCIL
APPROVING THE TAX-EXEMPT FINANCING FOR TERMINATION
PAYMENT OF POWER SUPPLY CONTRACT WITH
WASHINGTON WATER POWER COMPANY

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BE IT RESOLVED, that the Lodi City Council hereby authorizes the tax-exempt financing of the payment to Washington Water Power Company for termination of the Northern California Power Agency (NCPA) - Washington Water Power Company (WWP) power supply contract.

Dated: November 20, 1996

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I hereby certify that Resolution No. 96-172 was passed and adopted by the Lodi City Council in a regular meeting held November 20, 1996 by the following vote:

AYES: Council Members - Davenport, Mann, Sieglock and Warner (Mayor)

NOES: Council Members - None

ABSENT: Council Members - None

ABSTAIN: Council Members - Pennino


JENNIFER M. PERRIN
City Clerk